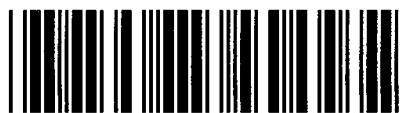




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PROJECT NO. 51871

REVIEW OF THE ERCOT SCARCITY
PRICING MECHANISM

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PUBLIC UTILITY COMMISSION
OF TEXAS

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**SOUTH TEXAS ELECTRIC COOPERATIVE, INC.'S INITIAL COMMENTS TO
COMMISSION QUESTIONS ON THE LOW SYSTEM-WIDE OFFER CAP**

TO THE HONORABLE PUBLIC UTILITY COMMISSION OF TEXAS:

COMES NOW, South Texas Electric Cooperative, Inc. ("STEC") and submits its Initial Comments in the above-styled proceeding. The deadline for the filing of Initial Comments to be considered in the above-styled proceeding is March 19, 2021, therefore these comments are timely filed.

I. INTRODUCTION

STEC appreciates the opportunity to provide comments to the Public Utility Commission of Texas ("PUCT" or "Commission") on the low system-wide offer cap ("LCAP"). A continued focus on accurate pricing signals and ERCOT system reliability in the context of any adjustments to the LCAP will help ensure that generation remains incented to come online, the system remains reliable, and that reserves are not further depleted.

II. COMMENTS

1. Should the Commission amend its rules to adjust the LCAP?

STEC believes that the Commission should amend 16 Texas Administrative Code § 25.505(g)(6)(A) to adjust the LCAP. STEC does not have a recommendation for the amount at which the LCAP should be set. However, STEC encourages the Commission to take a balanced approach in adjusting the LCAP to maintain the intent and structure of the LCAP, while simultaneously promoting appropriate market pricing signals and market reliability.

The winter storm event, and its subsequent fallout, have displayed the need for adjustment to the LCAP pricing mechanism to continue to incentivize generation to be available during scarcity events, when scarcity prices have reached levels necessary to cover the Cost of New Entry (“CONE”). In previous comments filed with the Commission, STEC has recommended that the Commission pursue policies that improve the transparency and accuracy of these pricing signals.

STEC would urge the Commission to adjust the LCAP in manner that continues to promote, and does not interfere with, appropriate market pricing signals needed both for generation adequacy and for ERCOT market reliability. In no event should the LCAP be adjusted in a manner that would further degrade resource adequacy or reliability, or exacerbate the revenue gap for sustaining baseload generation that has resulted in declining dispatchable reserves. The LCAP must be adjusted in a manner so as to not hinder the market’s ability to signal accurate scarcity pricing to incent needed generation investment.

It is imperative that competitive offering behavior from generators continues to occur, especially heading into Summer 2021 with a tight reserve margin of 15.5%, assuming the relied upon generation is available. Any adjustment to the LCAP must achieve accurate price signals to incent generation and sustain reliability across the ERCOT system. As the ERCOT market faces the coming challenges of tight summer conditions, with a diminished reserve margin, the changing composition of generation resources, and following the financial ramifications of the winter storm event, it is increasingly important that the market sends accurate pricing signals to encourage new entry in the market, and sustain existing resources.

2. If the Commission amends its rules to adjust the LCAP, what specific adjustments should it make?

Scarcity pricing is intended to provide both short-term and long-term economic signals. In the short-term, scarcity pricing incentivizes generation to be online and available for dispatch to meet urgent system reliability needs. The use of scarcity pricing as a reliability tool during the winter storm emergency has been a topic of considerable discussion in the aftermath of the event. Over the long-term, scarcity pricing is designed to keep marginal generation on-line that is not able to recover capacity costs under “normal” market conditions. It also gives the market assurances that investment in new generation is economic. Absent a capacity back-stop, both the short-term and long-term functions of scarcity pricing are essential and must be maintained as changes to the LCAP are considered. In furtherance of these goals, STEC makes the following recommendations:

- **Adjust the Value of the LCAP**

In previously filed comments, STEC has recommended that the Commission undertake a review of the LCAP value to determine whether the appropriate price is greater than \$2,000 per MWh. STEC continues to recommend such an evaluation and suggests that the Commission consider implementing an LCAP value that is tied to the CONE rather than a fixed value, but one that is not decoupled from natural gas. Natural gas is the marginal fuel in ERCOT, and generators must be incented to buy gas and run in LCAP scarcity events. However, STEC recommends that the LCAP should be capped at the HCAP.

A key element needed for an event-based model to be successful is to have a transparent and predictable timeline for market participants to have certainty around when an LCAP event would begin and end. Predictability is a circuit-breaker because it reduces market volatility,

enables loads to hedge their risk and limit exposure to high prices, and enables generation to make informed decisions regarding availability, system maintenance, fuel supply, and other operational concerns.

- **Implement an Event-Based on LCAP**

STEC recommends that the Commission consider an event-based LCAP that is triggered after a certain duration of scarcity pricing intervals within a specified timeframe. Currently the timeframe for the LCAP is somewhat arbitrarily tied to the calendar year. Implementing an event-based timeframe for the LCAP would provide balance between the competing priorities of incentivizing long-term investment and minimizing short-term market risk. The danger of keeping the status quo of an annual LCAP timeline is that prices will be capped too low to incentivize generation and maintain system reliability during the summer peak if the LCAP is reached during a winter peak, as occurred this year.

In testimony provided to the State Affairs Committee of the Texas House of Representatives, ERCOT described how pricing signals are the most effective tool available to ERCOT for ensuring that generation is available during scarcity events.¹ A key element needed for an event-based model to be successful is to have a transparent and predictable timeline for market participants to provide certainty concerning when an LCAP event would begin and end. In addition to reducing market volatility, predictability enables loads to hedge their risk and limit exposure to high prices, and enables generation to make informed decisions regarding availability, system maintenance, fuel supply, and other operational concerns.

¹ Testimony of Chairman D'Andrea (Mar. 16, 2021) http://tlchouse.granicus.com/MediaPlayer.php?viewid-46&clip_id-19666.

- **Coordinate LCAP Changes with RDPA and EEA3 Modifications**

One issue that has arisen from the events of Winter Storm Uri is the discussion around what level of system reserves were necessary during the emergency conditions and how those reserve levels should impact scarcity pricing. During normal conditions, reserves are considered to be adequate when they are above 2,300 MW. However, when ERCOT was in Emergency Energy Alert Level 3 (“EEA3”) and load was being restored onto the system, the overall system conditions led ERCOT to conclude that additional reserve levels were necessary to protect system reliability. STEC anticipates that this issue will be addressed as part of the overall analysis of how the market functioned during the winter storm. It is critical that the LCAP does not impair ERCOT’s ability to maintain system reliability. STEC therefore recommends that the LCAP be considered in conjunction with adjustments to the Reliability Deployment Price Adder (“RDPA”) or EEA3 provisions that would provide for a more accurate valuation of reserve levels when higher reserves are necessary. A lesson learned from the winter storm is that the system can be in scarcity conditions when reserve levels are well above 2,300 MW and scarcity pricing should reflect these reliability concerns during those circumstances.

3. If the Commission amends its rules to adjust the LCAP, when should these adjustments take effect?

STEC believes that any adjustments to the Commission to the LCAP should take effect as soon as possible. Market Participants expect certainty when operating in the ERCOT Market, so any Commission decision to change the rules of the game at this juncture should be relayed as quickly as possible to Market Participants. A delay in the implementation of adjustments to the LCAP will only serve to inject additional uncertainty into the market as Summer 2021 quickly approaches.

III. CONCLUSION

STEC appreciates the opportunity to provide comments to the Commission on these important issues.

Respectfully submitted,



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